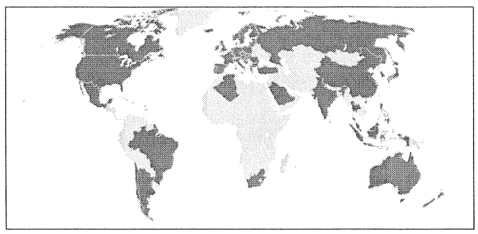
Evolving Bank Regulation Basel III: Liquidity Coverage Ratio

Agenda

- Basel III
  - Background
  - Liquidity
    - Deposits
  - U.S. Bank Impact
  - What does this mean to you?
  - "Basel III Friendly" Product Opportunities

Basel Committee

- Bank for International Settlements (BIS):
  The mission of the Bank for International Settlements (BIS) is to serve central banks in their pursuit of monetary and financial stability, to foster international cooperation in those areas and to act as a bank for central banks.
  - Established 1930
  - 58 member central banks or monetary authorities
  - Headquartered: Basel, Switzerland
- Basel Committee on Banking Supervision (BCBS):
  A committee of banking supervisory authorities who's objective is to enhance understanding of key supervisory issues and improve the quality of banking supervision worldwide.
  - Established by the BIS in 1974



Basel Accords (Basel I, II, III)

- **Basel I** (1988)
  - Initial Bank Capital Framework
  - Published a set of minimal capital requirements for banks
- **Basel II** (2004)
  - More comprehensive bank capital guidelines
  - "created an international standard that banking regulators can use when creating regulations about how much capital banks need to put aside to guard against the types of financial and operational risks"
  - *Note: Still being implemented*
- **Basel III** (2009)
  - Strengthened capital requirements & introduced liquidity requirements
  - Promotes a more robust banking system, worldwide, resulting from weaknesses exposed during the global financial crisis that began in late 2007. In the U.S., the responsibility for the review and implementation of Basel III standards includes: The Federal Reserve, Office of the Comptroller of the Currency (OCC) and Federal Deposit Insurance Corporation (FDIC).

Liquidity 101

Liquidity Defined:

- The capability to meet all required outflows of cash (payments, withdrawals, loan draws, etc) with available cash OR by borrowing against or selling assets.

Historical Approach:

- Provided customers with forms of cost effective liquidity:
  - Demand Deposits
  - Committed Lines of Credit
- Managed liquidity needs internally:
  - Reserves held on every deposit
  - Off-Balance Sheet Sources of Liquidity:
    - Collateralized Borrowing Capacity (Fed Discount Window, FHLB system)

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Basel III: Liquidity Ratio

- Proposed Basel III approach: Prescription based
  - Two ratios:
    - Liquidity Coverage Ratio (LCR): 30 day stress scenario
    - Net Stable Funding Ratio (NFSR): 1-year scenario
  - Focus on unencumbered liquid assets on-balance sheet (e.g. Cash, Treasuries, Agencies)
  - Liquid assets should be sufficient to cover "acute liquidity stress scenario" – assumes significant deposit runoff and high loan commitment draw downs

Liquidity Coverage Ratio

$$\frac{\textbf{Liquid Assets} \text{ (Cash, Treasuries, Agencies)}}{\textbf{Stressed Cash Outflows} \text{ (Liquidity Crisis: Withdrawals of deposits, draws on letters of credit, etc)}} \geq 100\%$$

- Conformance Timeline:
  - Minimum ratio of 80% required by January 1, 2015 then increasing annually by 10% until full implementation by January 1, 2017.
  - This schedule seeks compliance a full two years sooner than required by Basel
  - U.S. Regulators issued proposed rules for domestic implementation in October 2013.

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Basel III LCR: Deposits

- Deposits with a lower run-off will be more highly valued
- New Products which offer comparatively higher rates but come with lower flexibility for early withdrawal
- Proposed U.S. rules set a very high bar for qualification as an operational deposit. The rule limits the characteristics of operational accounts and requires a bank to identify excess balances beyond those held for operational purposes and assign them the higher runoff factor.
- U.S. Bank is taking action to ensure compliance with required LCR ratios ahead of the implementation schedule

Deposit/Liability Type	Description	Run-off Factor
Non-retail term products maturing > 30 days		0%
Retail/Small Business – Fully Insured	Fully FDIC Insured and multiple products	3%
Retail/Small Business – Not Fully Insured	Aggregate balances that exceed FDIC insurance limits. Entire balance receives this factor	10%
Corporate/Commercial/Financial deposits	Operational	25%
Corporate/Commercial deposits	Non-operational	40%
Deposits from financial companies	Non-operational	100%

What does this mean for you?

- Banks will be placing a greater emphasis on balances:
  - with longer terms OR;
  - as part of a larger relationship with the bank
- U.S. regulators established an accelerated conformance period, during which banks will be expected to work toward 100% compliance on the Liquidity Coverage Ratio
- Banks are seeking clarity in proposed rules and working to identify unintended consequences during the rules comment period (which ended 1/31/2014)
- When final rules are issued (expected mid-2014) banks will have to move *aggressively* to achieve full compliance
- Working with customers to create or modify products to be more "Basel III friendly"
- These changes represent a true cost to the industry

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"Basel III Friendly" Product Opportunities

Products accepted for Counties within Nebraska Statutes

US Treasury Securities

- US Treasury Bills – purchased at a discount with a maturity of one year or less
- US Treasury Notes – interest bearing with maturities ranging from two to ten years

Federal Agency Securities

- Agency Discount Notes – purchased at a discount with a maturity of one year or less
- Agency non-callable bonds and callable bonds – interest bearing with maturities of one to thirty years
- Issuing Agencies
  - Federal Home Loan Bank
  - Federal Farm Credit Bank
  - Federal Home Loan Marketing Association
  - Federal National Mortgage Association

  - These securities may incur an additional safekeeping cost. Please consult your representative for further details

Disclosures

Deposit Products offered by U.S. Bank N.A. Member FDIC.

Investment products, including shares of mutual funds, are not deposits or obligations of, or guaranteed by U.S. Bank or any of its affiliates, nor are they insured by the Federal Deposit Insurance Corporation, or any other government agency. An investment in such products involves risk, including possible loss of principal.

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